Wealth Planning Update

Do Not Delay – Revisit Your Estate Plan

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Key Takeaways:

- In December 2017, the estate, gift, and generation-skipping transfer (GST) exemptions doubled, but this change is not permanent and may change sooner than anticipated.
- In light of tax reform, it is important to review and discuss the appropriateness of current estate plans with your tax and legal advisors.
- Consider making lifetime gifts to "lock in" the increased exemption amounts.

What this may mean for you:

- Now is the time to revisit your estate plan to ensure it is tax-efficient and helps achieve your objectives.

The Tax Cuts and Jobs Act of 2017 (the act) doubled the estate, gift, and generation-skipping transfer (GST) tax exemptions to $11,400,000 in 2019, which may have led you to put off reviewing your estate plan. However, this is not the time to be complacent. Under this law, the exemptions will revert back to 2017 levels (adjusted for inflation) at the beginning of 2026. Furthermore, legislative changes may accelerate the changes in the exemptions as well as the estate tax rate.

This Wealth Planning Update discusses potential estate planning strategies to take advantage of the current exemption amounts. It also looks at why now may be a good time to review your plan with your tax and legal advisors to determine how the lower exemption amounts in the future may affect you, whether the change occurs in 2026 or sooner.

Where are we today?

Under current law:

- The estate and gift tax "applicable exclusion" is $11,400,000 per person ($22,800,000 for married couples, with proper planning) in 2019. This amount will be adjusted for inflation in future years.
- The GST tax exemption is the same level, adjusted for inflation annually.
- The estate, gift, and GST tax rate is 40%.
- The annual gift exclusion amount is $15,000 per beneficiary for 2019, adjusted for inflation.
- The "portability" election, which lets a surviving spouse use the deceased spouse's unused estate tax applicable exclusion amount, is still available. Note: Portability does not apply to an unused GST exemption.

Under the act, the increases in the applicable exclusion amounts are scheduled to revert back to 2017 levels ($5,490,000), adjusted for inflation, in 2026. This means there is a limited time period to take advantage of the increased amounts that can pass free of estate, gift, and GST taxes.

Lifetime gifting opportunities in light of tax reform

The current estate, gift, and GST tax exemptions offer various planning opportunities for individuals who plan to make large lifetime gifts either in the future or after their death. To lock in the increased exemption amount, work with your advisors to identify lifetime gifting opportunities before the act's provisions sunset and prepare for potential legislative changes that may occur before the current sunset date. There are a variety of options available, but the appropriateness of each should be discussed with your tax and legal advisors based on your specific circumstances.

Spousal lifetime access trust

You may be reluctant to make lifetime gifts to an irrevocable trust because, for example, of the loss of control over the contributed assets or that it will deplete your funds where you will no longer be able to maintain your standard of living. Using a spousal lifetime access trust (SLAT) may alleviate these concerns for married couples. A SLAT is an irrevocable trust that is funded during the donor's lifetime using annual exclusion gifts, applicable exclusion gifts, and/or taxable gifts that provides access to the asset and future appreciation through the beneficiary spouse as long as they remain married.

Power of appointment support trust

A power of appointment support trust (POAST) is a useful tool when the second generation has accumulated wealth while the first generation is under the federal estate exemption while also supporting that senior family member. If a POAST is properly structured, the GST tax exemption may protect POAST assets from future transfer tax for multiple generations of the grantor's family as well as providing for a date-of-death basis adjustment of trust assets on the POAST in the senior-generation family member's death, reducing or eliminating the potential income tax on appreciated assets later sold by the trust.

Grantor retained annuity trust

A grantor retained annuity trust (GRAT) is a technique that allows for the appreciation of trust assets being excluded from the donor's estate and the assets transferred to family members with minimal tax implications. GRATs may be funded with a wide variety of assets, including marketable securities, closely held business interests, private equity, or hedge funds, and can be structured to produce little to no taxable gift.

Since GRATs are grantor trusts, there is a potential income tax advantage to funding them as the donor will be responsible for paying the taxes on all income items attributable to the trust property on their personal income tax return. Tax payments will further reduce the donor's estate while the assets potentially grow tax-free. With income tax rates remaining low and the additional lifetime exclusion amounts, one may want to consider placing appreciating assets into GRATs to remove them from a taxable estate.

Forgiveness of promissory notes from previous transactions

If you have any promissory notes from previous transactions, you may want to consider forgiving them in order to use the additional exclusion amount the act provides. Discuss outstanding promissory notes with your advisors to determine whether this is an appropriate way to use this exclusion.

Charitable giving

While making lifetime gifts to charitable organizations does not use your lifetime exclusion, it does provide a means for shifting assets out of your taxable estate as well as potentially offering income tax savings. With the standard deduction increasing to $12,000 and $24,000 for individuals and married couples (filing jointly), respectively, it is assumed that fewer people are likely to itemize deductions. However, larger donors, especially those with higher incomes, may continue to benefit from itemized charitable deductions.

You may consider grouping several years' worth of charitable contributions into a single year to help increase income tax savings. This can be done through a one-time lump sum gift to a qualifying charitable organization or a large gift to a donor advised fund, which can then be distributed over several years. Further, if you are at least 70½ years old, you have the option to make charitable contributions of up to $100,000 per year from your IRA, which will be excluded from your gross income (but not available as a charitable deduction).

Planning opportunities with current estate plans

Reviewing current estate plans

While the increased exemptions mean fewer people are currently subject to federal estate taxes, it may also result in existing estate plans having unintended consequences. Now is the time to revisit estate planning documents, to ensure they are tax-efficient and help achieve your planning objectives.

Managing tax basis

A key discussion of gifting during life versus bequeathing assets is that of the step-up in cost basis. When a gift is made, the asset's cost basis is carried over to the recipient. However, if held until death, the asset's basis is stepped up to the fair market value at the time of death. Given the larger gift exemption now available, additional attention should be paid to tax basis when reviewing existing estate plans.

Rethinking 'credit shelter' trusts

Many plans for married couples call for automatic maximum funding of a "credit shelter" or "bypass" trust at the first spouse's death using a formula based on the applicable exclusion amount. Unless the plan is updated, this could result in less-than-optimal use of the deceased spouse's exclusion and sacrifice the opportunity for a step-up in cost basis at the surviving spouse's death.

Effectively using the GST exemption

For married couples, any unused GST exemption is typically allocated on the death of the first spouse to die by bequest of the estate applicable exclusion amount. Because the GST exemption is not portable, if the gift of the estate applicable exclusion amount is limited to what can pass without incurring state estate taxes, a portion of the GST exemption might be wasted. You may want to consider allocating any remaining GST exemption to a trust for the surviving spouse that will qualify for the marital deduction.

Reviewing titling of assets

As you review your estate plan, pay attention to the titling of your assets. For married couples, depending on the provisions of their estate plan, each spouse should have sufficient assets in his or her name to fully utilize the estate and GST exemptions at death.

Remembering state estate taxes

A number of states, like New York and Connecticut, are “decoupled” from the federal estate tax regime, meaning that their applicable exclusion amounts do not match the federal amounts. Estate plans should be reviewed to make sure gifts of the federal applicable exclusion amount will not result in a state estate tax being due upon the first spouse’s death.

Now what?

The act resulted in a significant change to estate, gift, and GST tax law that affects every taxpayer differently. As a result, these provisions require careful consideration and strategic planning now in order to be prepared for the possibility that the current exemptions will revert back to adjusted-for-inflation 2017 levels before the December 31, 2025, sunset date. Speak with a Wells Fargo relationship manager to discuss working with a Wealth Planning Specialist as well as your estate planning attorney and tax advisor to help determine what action steps may be appropriate for you.

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